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No. 86-1981

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1986

SUN SHIP, INC.,
Petitioner,

vs.

CALIFORNIA AND HAWAIIAN SUGAR CO.

and

HALTER MARINE, INC.,
Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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INTRODUCTION

The Opposition ("Opposition") by California and Hawaiian Sugar Company ("C&H") to the Petition for Certiorari filed by Sun Ship, Inc. ("Sun") describes the Petition as "frivolous," "melodramatic" and "silly" and accuses Sun Ship of "misleading" this Court. It sidesteps the issues raised by Sun with a barrage of *ad hominem* attacks and an implied characterization of Sun as a "big guy" taking advantage of a small "non-profit agricultural cooperative."[1]

Sun does not pursue "frivolous" appeals. On rehearing the Ninth Circuit excised crucial language from its opinion and Judge Nelson voted to rehear the case. The "facts" stated by C&H as a ground for rejection of the Petition were *not* found as "facts" by either the District Court or Ninth Circuit. For example:

(a) C&H's Opposition states (at page 5) that "initially the parties *agreed* that Sun was obligated to pay liquidated damages during a period of concurrent delay in performance by Sun and Halter." The statement is wrong. There was no "agreement" that liquidated damages were payable during a period of concurrent delay. Liquidated damages payments were instead made because it was arguably a breach to fail to pay even disputed amounts. *All* of Sun's payments were made under a *reservation of rights* which keyed C&H's right to retain them to an ultimate determination of responsibility for delay. Why, if C&H and Sun had "agreed" to anything, did C&H choose to sue Sun on March 5, 1982 and ask the Court to declare that it could keep the money?

(b) At page 4, C&H's Opposition states that "in violation of the contract . . . Sun unilaterally subcontracted construction of the Barge to Bath Iron Works in Maine." The contract contains *no* language which prevented subcontract-

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[1] Pursuant to Supreme Court rule 28.1, Sun refers to the Statement of Affiliated Companies contained in its Petition for Certiorari. Though Sun's size is irrelevant with respect to the legal issues surrounding the grant of Certiorari, it should be noted that the C&H "members" may collectively be even larger than Sun Company. Those "sugarcane growers" include: Hawaii's "Big Five", i.e. Amfac, Inc., Castle & Cooke, Inc., Alexander and Baldwin, Inc., Theo. H. Davis & Co., and C. Brewer & Co.

ing. The court below made *no* such finding. The only evidence before the District Court was that C&H on numerous occasions acknowledged and accepted the Bath subcontract.

(c) C&H states (Opposition at 4) that (emphasis added):

> Sun was understandably concerned that it not be subject to liquidated damages *where it had done all it could to perform its obligations* but was unable to complete performance on time because Halter had not made the tug available.

Here, the misstatement is more subtle. There is *no* contractual precondition that Sun must have "done all it could to perform its obligation" before it could seek an extension. The actual language of Article 7(b) affords Sun a right to an extension in the event of a delay caused by Tug unavailability "where it is determined that Contractor has complied with all obligations under the Interface Agreement." The difference between C&H's paraphrase and the actual text is critical. Sun's contract work included the integration, testing, trials and delivery *of an ITB*.[2] By definition, the Tug's unavailability "actually delayed" the completion of Sun's work, a delay which was ratified by C&H itself when it entered in a settlement agreement which effectively extended the Tug availability date to July, 1982. Moreover, C&H's counsel at trial stipulated that Sun had complied with its obligations under the Interface Agreement. The *stated* prerequisites for an extension under Article 7(b)—Tug unavailability and compliance with the Interface Agreement—were thus fulfilled.

Yet the June 30, 1981 Delivery Date in the *Sun* contract was not extended by a single day. The result is that C&H, having

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[2] There was never a "delivery date" for the unconnected barge. This was noted by Judge Aguilar in his Opinion and Order Denying C&H's Motion to Compel Arbitration dated January 31, 1983. "Pursuant to the terms of the contract entered into between C&H and Halter, Halter was to have completed and delivered the tug portion of the ITB to Sun Ship for mating by April 30, 1981. Pursuant to the contract between C&H and Sun Ship, Sun Ship was to have completed the mating process and delivered the ITB to C&H by June 30, 1981. There was no provision in the contract between C&H and Sun Ship for when the barge portion of the ITB was to be completed by Sun Ship." Opinion p. 2.

garnered $4 million in benefits from the Halter settlement, has been awarded an additional $4.4 million in liquidated damages, notwithstanding the fact that its actual damages from the delay in the ITB were found to be $368,000.

C&H argues that if error has been committed, it does not merit review. But the decision of the Ninth Circuit has ramifications far beyond the borders of Pennsylvania. Multiparty construction projects are common, and liquidated damages provisions are near-universal in the industry. The Ninth Circuit has now created a general rule which would permit liquidated damages to be collected in situations that were concededly unanticipated by the parties and where actual damages are insignificant. This result creates uncertainty for any party entering into contracts under the law of Pennsylvania or other jurisdictions which look to the Uniform Commercial Code ("UCC") or the *Restatement (Second) of Contracts* ("Restatement"). It will create inter-circuit conflicts, particularly between the Ninth Circuit and the Third Circuit, the latter of which is *the* circuit entitled to deference on the points raised herein. In sum, the Ninth Circuit's decision is more than erroneous: it is a violation of *Erie Railway Co. v. Tompkins*, 304 U.S. 64 (1938), that is so egregious as to require this Court's exercise of its supervisory powers.

ARGUMENT

I

THE NINTH CIRCUIT'S DISREGARD OF PENNSYLVANIA LAW COMPELS THIS COURT'S REVIEW

A. C&H Fails To Grapple With The Fact That, *As Amended*, The Opinion Cannot Be Supported Under Either Of The Prevailing American Tests For Liquidated Damages

Read closely, the Opinion of the Ninth Circuit ("the Opinion") evades *both* of the tests generally applied to liquidated damages clauses, i.e. that such a clause be reasonable (a) at its inception, and/or (b) in light of actual damages.

On the question of original intent, the Opinion concedes that the parties did *not* anticipate that the Tug would *never* be available to Sun for interconnection to the Barge. To the extent the parties had anticipated the possibility of Tug delay, Article

7(b) confirmed that liquidated damages would *not* be assessed where the Tug is "unavailable for interconnection to the Barge."

Article 7(b) presented the greatest difficulty to C&H, the Special Master, and the Ninth Circuit. The Special Master avoided it by finding that the Barge had to be *completed* before the Delivery Date in the Sun contract could be extended under Article 7(b). The contract is bereft of any such precondition, since it would have been ridiculous to require Sun to *complete* the Barge when parts of it might then have to be redone to conform with the as-built specifications of the Tug.

The Ninth Circuit ignored Article 7(b) entirely. *The net result was that substantial liquidated damages were validated in a circumstance (delay in Barge completion where the Tug remained unavailable) where no substantial actual damages could ever have been suffered by C&H.* This approach to liquidated damages was flatly condemned by this Court in *Priebe & Sons, Inc. v. United States*, 332 U.S. 407 (1947).[3]

In fact the Ninth Circuit did *not* state unambiguously that the clause here was valid at its inception. Instead it turned to C&H's actual damages, which were expressly found not to exceed $368,000. Understandably, the Court shied away from any finding that this amount is reasonably proportionate to the $4.4 million in liquidated damages awarded to C&H.[4] In defending the Court, C&H clings to the argument that C&H suffered additional

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[3] C&H argues that whether a liquidated damages clause is enforced for its *in terrorem* effect presents a question of fact. C&H's position is refuted by *Priebe*, which holds as a matter of law that a liquidated damages clause may not be enforced against a breach which could not have resulted in the damages for which the clause was intended to compensate. 332 U.S. at 413. Contrary to C&H's assertion that *Priebe* "was decided *before Erie*", [Opposition at 17] *Priebe* was decided a full 12 years *after Erie*.

Any interpretation of the liquidated damages clause which results in enforcement in the situation that developed—Tug unavailability—also runs afoul of the Pennsylvania rule prohibiting a single liquidated damages amount for breaches of varying severity, *Gross v. Exeter Machine Works*, 277 Pa. 363, 121 A. 195, 197 (1923).

[4] *See Germain Lumber Co. v. United States*, 56 F. Supp. 1001 (W.D. Pa. 1944); *Doolan v. Doolan Steel Corp.*, 591 F. Supp. 1506 (E.D. Pa.), *aff'd*, 772 F.2d 894 (1984).

"substantial" damages, though in an "uncertain" amount. In doing so, C&H cites five excerpts from *Corbin on Contracts* which purportedly establish *Clydebank Engineering and Shipbuilding Co.* [1905] A.C.6, as the foundation of American liquidated damages law. Yet, only one of these is remotely relevant to this case. It supports Sun. *Corbin* (at § 1072) states that construction contracts often provide that a fixed sum shall be paid for each day's delay in completion beyond the date agreed upon. It further states that because of the difficulty in determining the injury caused by such delays, courts are inclined to enforce *reasonable* liquidated damages clauses. However, *Corbin* notes that the underlying rationale behind this rule is that "[t]he delay prevents possibility of use by the promisee; *and it can seldom be shown that no use would in fact have been made had completion been on time, or that no profit would have been made from such use.*" 5 *Corbin*, § 1072 (emphasis added). This is that rare case, where, as C&H has admitted, there was no use whatsoever that could be made of the highly specialized Barge alone. Thus, a liquidated damages clause premised on "mountains of sugar" being left in Hawaii could not properly be applied to Sun until C&H had made the Tug available for interconnection.

More critical is that the Special Master rejected the so-called "uncertain" damages as unproved. Reminded of that finding, the Ninth Circuit simply excised that portion of its Opinion, without considering that absent those alleged charter-hire losses, there was nothing "uncertain" to justify liquidated damages of a magnitude far greater than C&H's actual damages.

The result is an ambiguous opinion which seems to hold that a liquidated damages clause concededly reasonable in one situation may be enforced in totally different circumstances, even though (a) the parties did not anticipate its enforcement in the new situation, and (b) actual damages are grossly disproportionate to the liquidated damages. This is not the law of Pennsylvania,[5] any

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[5] At footnote 5 of its Opposition, C&H cites *Silco Vending Co. v. Quinn*, 315 Pa. Super 367, 461 A.2d 1324, 1327 p. 4 (1983) as support for its contention that the conjunctive test in *Unit Vending Corp. v. Tobin Enterprises, Inc.*, 168 A.20 750 (1961), is a mere quirk in the law, and does not represent the rule in Pennsylvania. In *Silco*, at footnote 4, the Court stated that the lower court made "no findings of fact as to [actual] losses suffered by Silco, and we are *thus* unable to assess the

other UCC jurisdiction or any jurisdiction which follows the liquidated damages provisions of the Uniform Commercial Code and the *Restatement (Second) of Contracts.*

B. Double Recovery and Multiple Fault

Liquidated damages clauses are not a device whereby a party may escape defenses that are otherwise available against it, and thereby reap a windfall. This general principle gives rise to three specific rules which are as effective in Pennsylvania as elsewhere:

1. *If an owner shares responsibility for project delay, he may not impose total liability on a contractor through the device of a liquidated damages clause.* A project may be delayed both because the contractor is running behind schedule and because the owner has not performed tasks necessary for the contractor to complete the job. The "better rule" (and Pennsylvania law) in such circumstances is to disregard any liquidated damages clause which, in effect, would shift *all* damages to the contractor.[6] Instead the owner must prove its actual damages, and the court must apportion them between the parties. The fact that the owner has delegated its reserved responsibilities to other contractors does not absolve the owner from its responsibility vis-a-vis the contractor for their defaults.[7]

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reasonableness of the damages clause on the facts of this case". The case was therefore remanded.

C&H's unexplicably cites *Harris v. Dawson*, 239 Pa. Super. 316, 360 A.2d 706 (1976) for its view that *Unit Vending Corp v. Tobin Enterprises, Inc.*, 168 A.20 750 (1961), is not the law in Pennsylvania. But *Harris* specifically cites *Unit Vending* as the appropriate test, stating that in an action for damages, the liquidated sum is "void as a penalty in view of its unreasonableness *in light of actual damages.*" 360 A.2d at 708 (emphasis added).

[6] *See Department of Transportation v. W. P. Dickerson & Sons, Inc.*, 42 Pa. Commw. 359, 400 A.2d 9[illegible], 933 (1979); *Department of Property & Supplies v. Berger*, 11 Pa. Commw. 332, 312 A.2d 100, 106 (1973); *Pittsburgh Die Sinkers Lodge No. 50 v. Pittsburgh Forgings Co.*, 255 F. Supp. 142, 145 (W.D. Pa. 1966).

[7] The relevance of C&H's status as its own prime contractor becomes apparent. If *Sun* had been the prime contractor and responsible for Halter's performance vis-a-vis C&H, there would be no question of the enforceability of the clause herein, or of Sun's right to contribution from Halter. *See generally,* Wickwire & Smith, *The Use of Critical Path*

2. *Delay by one of several contractors does not result in "joint and several liability" for all damages relating to project delay if it may be seen that other contractors were also late. Instead damages must be apportioned.* Every complex construction project has a "critical path", i.e., a schedule of tasks, the timely completion of which is essential for the continuation of the overall work. *See* Wickwire & Smith, *supra*. There are also subordinate tasks the delays of which (depending on circumstances) will not affect completion of the project as a whole. Because of this, an owner, even in the event he has suffered actual damages from project delay, may not shift liability for the entire loss on whichever contractor or supplier has the deepest pocket. Instead, he must distinguish by hindsight which delays have had a corresponding impact on overall project completion, and which have occurred during "float time", and have not affected project completion. *Id. Damages, whether actual or liquidated, are apportioned accordingly. S.J. Groves & Sons Co. v. Warner Co.*, 576 F.2d 524, 527 (3d Cir. 1978).[8] The Ninth Circuit ignored this precedent, and instead imported the doctrine of "joint and several liability" from the law of torts, where its harshness is tempered by countervailing doctrines of single recovery, contributory negligence, comparative fault, and contribution. This strange brew has no precedent in construction law.

3. *A party that is damaged due to a breach of contract is entitled to only one satisfaction for the damage incurred. Lambert v. Durallium Products Corporation*, 364 Pa. 284, 72 A.2d 66 (1950); 22 AM JUR. 2d (Damages) §§ 12-13. Any finding of joint and several liability gives rise to the danger that a plaintiff will attempt to obtain multiple recoveries through litigation or settlement from the various potential defendants. The law of Pennsylvania, as of most jurisdictions, is that the value received by a plaintiff from settling or litigating with co-responsible parties must be deducted from the amount sought from others. *Id.* Here,

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Methodology in Contract Claims, 7 Pub. Cont. L.J. 1 (1974). But here, *C&H* retained responsibility for providing the Tug to Sun, and itself delegated that responsibility to Halter.

[8] *See also E.C. Ernst, Inc. v. Koppers Co., Inc.*, 476 F.Supp. 729 753-54 (W.D. Pa. 1979); *G.C.S., Inc. v. Foster Wheeler Corp.*, 437 F.Supp. 764, 766-67 (W.D. Pa. 1977). *Lichter v. Mellon-Stuart Co.*, 193 F.Supp. 216 (W.D. Pa. 1961), *aff'd*, 305 F.2d 216 (3d Cir. 1962).

C&H's total actual damages were found to be $368,000. It is not disputed that C&H settled with Halter, and thereby obtained a release of counterclaims worth well in excess of $4,000,000.[9] The Ninth Circuit would add to that an award of $4.4 million in liquidated damages against Sun—a clear windfall for C&H. Allowing a liquidated damages clause and a clandestine settlement to be used as a subterfuge for a multiple recovery is without precedent.

C&H argues that "Sun's unspoken premise is that two wrongs make a right—that where two concurrent defaults cause an injury, neither wrongdoer can be held liable." Opposition at 15. That is the lamest canard in the C&H repertoire: the issue here is apportionment of actual damages between the delaying parties, not exoneration of any of them.[10]

II

THE NINTH CIRCUIT'S DISREGARD OF PENNSYLVANIA LAW IS IMPORTANT ENOUGH TO MERIT THIS COURT'S REVIEW

A. The Effect Of The Decision Will Be Felt Far Beyond Pennsylvannia

Fifty jurisdictions, including Pennsylvania, have adopted the UCC's liquidated damages provision. At least thirty eight of these follow the *Restatement* formulation with respect to liquidated

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[9] The fact that Halter and C&H failed to assign a specific dollar value to their settlement should not have insulated it from scrutiny. *Ratner v. Sioux Natural Gas Corp.*, 719 F.2d 801, 803 (5th Cir. 1983) (One satisfaction rule applied where prior settlements with other parties had no stated dollar value, and remanded for a determination of the value of the earlier settlement in order that the value could be credited so the plaintiff would receive but one satisfaction).

[10] The Tug, Barge and Interface Agreements together establish a "critical path" applicable to all parties, and if read together would have clearly made Halter responsible for delays *prior* to Tug availability, and Sun responsible thereafter. This contractual apportionment insured C&H against being left without a remedy. Here, as elsewhere, the Ninth Circuit ignored the near-universal rule that related contracts must be interpreted together and in light of their overall goals. *Williston on Contracts*, § 628, at 904 (3d. Ed. 1961).

damages. Both federal and state courts applying the law of any of those jurisdictions will look to the Ninth Circuit decision, not just for guidance on Pennsylvania law, but also for interpreting the *Restatement* and the UCC. Liquidated damages clauses are also crucial in construction cases, where fault may be shared among literally dozens of contractors and suppliers operating in complex time sequences. The Opinion represents a radical departure from construction law "critical path" analysis.

B. This Case Presents An Important Intercircuit Conflict

The Ninth Circuit's purported application of Pennsylvania law conflicts radically with that of the Third Circuit in *Finkle v. Gulf & Western Mfg. Co.*, 744 F.2d 1015 (3rd Cir. 1984), which accepted *Unit Vending* as the proper Pennsylvania test for liquidated damages. Under *Erie*, this Court accords deference to the decision of federal judges trained and sitting in the jurisdictions the laws of which they apply. *Bernhardt v. Polygraphic Co. of America*, 350 U.S. 198 (1956). The Third Circuit's interpretation of Pennsylvania law should prevail and that of the Ninth Circuit should be reversed.

C. The Ninth Circuit's Opinion Is Such A Flagrant Violation Of *Erie* As To Call For This Court's Exercise Of Its Supervisory Powers

C&H, argues that however flagrant the Ninth Circuit's disregard of Pennsylvania law, this Court "does not sit to decide state law issues," and should deny Sun's petition. Opposition at 5. C&H misses the point. *Erie* prohibits federal courts from creating substantive law in diversity cases. The Ninth Circuit knew that under the published Pennsylvania authority, liquidated damages clauses must be reasonable (a) at their inception, and (b) in the light of actual damages. With no clear finding being possible as to either of the accepted tests, the Ninth Circuit chose to impose its own "uncertainty" analysis based upon Scottish law. This deliberate formulation of its own rule of substantive law violates *Erie*. Absent review, the Ninth Circuit decision will have sanctioned a new form of judicial activism that would strip the states of their constitutionally-derived power to have their substantive laws govern diversity cases in federal courts.

CONCLUSION

If allowed to stand, the Ninth Circuit decision will be cited for two general propositions:

1. That liquidated damages that are reasonable in one context can be enforced in other unanticipated contexts where there is no reasonable relationship between actual harm and the amount liquidated; and

2. That in a construction project with multiple contractors, and concurrent delays, any one of the contractors may be jointly and severally liable for all damages suffered by the owner, without an offset for amounts received by way of settlement, or otherwise, from the other contractors.

Pennsylvania law does not support these propositions. For all its vituperation, C&H's Opposition cites no Pennsylvania authority for them. The Ninth Circuit has in effect imposed its own common law on the Commonwealth of Pennsylvania and, potentially, on other American jurisdictions.

Sun's Petition for Certiorari should be granted.

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